

Message Text

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C O N F I D E N T I A L JAKARTA 9556

E.O. 11652: GDS
TAGS: ENRG, ID
SUBJECT: NEW IRS GUIDELINES ON FOREIGN TAX CREDITS

REF: A) JAKARTA 9445; B) STATE 177348

1. SUMMARY: FIRST REACTION TO IRS GUIDELINES STATEMENT FROM OIL SIDE OF GOI IS ONE OF SERIOUS CONCERN. END SUMMARY.
2. EMBOFF SPOKE WITH GOWLI (SECRETARY TO PERTAMINA BOARD OF COMMISSIONERS), KEY GOI OFFICIAL INVOLVED IN BOTH IRS RULING AND DISCUSSIONS WITH PRODUCTION-SHARING CONTRACTORS, ABOUT JULY 14 IRS PRESS STATEMENT. GOZALI WAS BROADLY AWARE OF MAIN POINTS, HAVING BEEN BRIEFED BY SOME OF THE OIL COMPANIES HERE.
3. GOZALI INDICATED THAT HE WAS CONCERNED BY IRS GUIDELINES STATEMENT AND FELT THAT GUIDELINES COULD, DEPENDING ON HOW THEY MIGHT ACTUALLY BE FOLLOWED, CREATE DIFFICULTIES NOT ONLY FOR CURRENT PRODUCTION-SHARING NEGOTIATIONS, BUT ALSO FOR FUTURE OF PRODUCTION-SHARING CONCEPT IN INDONESIA. HE SAID HE WAS PARTICULARLY WORRIED BY LANGUAGE IN PRESS RELEASE WHICH STATED THAT CREDITABLE TAX WOULD NOT BE RECOGNIZED "UNLESS THAT GOVERNMENT ALSO REQUIRES PAYMENT OF AN APPROPRIATE ROYALTY OR OTHER CONSIDERATION FOR THE PROPERTY THAT IS COMMENSURATE WITH THE VALUE OF THE CONCESSION."

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4. GOZALI SAID GOI IS EXTREMELY SENSITIVE TO WORDS

LIKE "CONCESSION," WHICH IMPLY COMPANIES ACTUALLY "OWN" OPERATING AREAS. USE OF THIS WORD, HE STATED, IS LIKE WAVING RED FLAG BEFORE INDONESIAN PARLIAMENT. SPECIFIC GUIDELINES REQUIRE THAT P.S. COMPANIES MUST ALSO PAY ROYALTY OR OTHER CONSIDERATION IS CONCEPT WHICH PRESENTS GOI WITH SOME DIFFICULTY SINCE BASIC PHILOSOPHY IN INDONESIAN PRODUCTION-SHARING CONCEPT IS THAT TRANSFERS BETWEEN COMPANY AND GOI ARE TRANSFERS OF INCOME, NOT ROYALTIES. ANOTHER PROBLEM AREA WAS CONSOLIDATION OF TAX LIABILITY ON BASIS P.S. COMPANY'S ENTIRE OPERATIONS WITHIN INDONESIA. CURRENT GOI POLICY IS FOR COMPANY TO SIGN SEPARATE PRODUCTION-SHARING CONTRACT FOR EACH MAJOR AREA IN WHICH COMPANY OPERATES AS "SERVICE CONTRACTOR" TO GOI. SOME COMPANIES PRESENTLY HAVE AS MANY AS FIVE PRODUCTION-SHARING AGREEMENTS. GOZALI ALSO THOUGHT NEW IRS GUIDELINES WOULD COMPLICATE PAYMENT OF BONUSES WHICH COMPANIES MAKE TO GOI FOR PRODUCTION, DRILLING, SIGNATURE, ETC., UNDER CURRENT SYSTEM. HE FORESAW DIFFICULTIES HERE IN DEFINING THESE BONUSES AS EITHER DEBT OR EQUITY. GOI WISHES TO TREAT THESE PAYMENTS AS EQUITY BUT FEARS IRS GUIDELINES WILL MAKE THIS DIFFICULT.

4. GOZALI SAID HE HAD NOT YET FORMALLY PRESENTED THIS LATEST IRS PRONOUNCEMENT TO GOVERNMENT, I.E. DEPARTMENTS OF FINANCE AND TRADE AND BAPPENAS. HE ANTICIPATED DIFFICULTIES FROM HIS COLLEAGUES FROM FINANCE WHO, HE SAID, OBJECTED TO IRS'S FIATS ON HOW COUNTRIES LIKE INDONESIA SHOULD TAX U.S. COMPANIES ABROAD. CONTRARY TO VIEW EXPRESSED PARA 4 REF B, GOZALI WONDERED IF ROGERS AND WELLS ORIGINAL RECOMMENDATIONS WOULD STILL SUFFICE IN LIGHT OF NEW IRS GUIDELINES.

5. COMMENT: REACTION AND COMMENTS OF GOZALI, WHO HAS BEEN CLOSELY INVOLVED IN WHOLE IRS PROBLEM, ARE SIGNIFICANT. INDONESIANS ON OIL SIDE OF GOVERNMENT ARE CLEARLY DISTURBED ABOUT CONSEQUENCE THIS LATEST IRS STATEMENT COULD HAVE ON FUTURE VIABILITY OF PRODUCTION-SHARING ARRANGEMENTS. USE OF WORD "CONCESSION" APPEARS TO BE PARTICULARLY UNFORTUNATE AND CONFIDENTIAL

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COULD HAVE SERIOUS POLITICAL REPERCUSSIONS NOT ONLY IN INDONESIA BUT ELSEWHERE. TIMING OF STATEMENT, COMING AT MOST CRUCIAL MOMENT IN PRODUCTION-SHARING CONTRACT NEGOTIATIONS, WILL ALSO BE VIEWED WITH GREAT SUSPICION BY GOI, PARTICULARLY AGENCIES OUTSIDE OF OIL SECTOR WHO ARE NOT FAMILIAR WITH DETAILS THESE NEGOTIATIONS AND THEIR PROBLEMS.
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